No. 20,981

In the

# United States Court of Appeals

*for the Ninth Circuit*

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JOHN M. ENGLAND, as Trustee of the Estate of MAHL ASSOCIATES, INC., a corporation, Bankrupt,

*Plaintiff and Appellee,*

vs.

ARCHIE SNIDER, individually and doing business as SNIDER CONSTRUCTION CO.,

*Defendant and Appellant.*

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On Appeal from the United States District Court for the Northern District of California, Southern Division

## Opening Brief of Appellant Archie Snider, Individually and Doing Business as Snider Construction Co.

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SORG PRINTING COMPANY OF CALIFORNIA, 346 FIRST STREET, SAN FRANCISCO 94105

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## I.

### PRELIMINARY STATEMENTS

#### A. Opinion Below.

The District Court filed a Memorandum of Opinion that appears at pages 42-47 of the Transcript of Record.

**B. Jurisdiction.**

This action was brought by a trustee in bankruptcy to set aside an alleged voidable preference in favor of the defendant. Jurisdiction was confirmed by §§ 60 and 67 of the Bankruptcy Act. Defendant's appeal from the adverse judgment was timely prosecuted pursuant to Rule 73, Federal Rules of Civil Procedure.

**C. Statement of the Case.**

Plaintiff-appellee is the trustee in bankruptcy of Mahl Associates, Inc., a corporate bankrupt. Defendant-appellant is an individual. Plaintiff seeks $15,668.68 plus interest from March 20, 1962 on the ground that defendant received a voidable preference from the bankrupt.

Defendant contended that the transfer did not occur while Mahl Associates was insolvent, but even if it did, he neither knew nor did he have reasonable cause to believe at that time that Mahl Associates was in fact insolvent.

The trial court sitting without a jury found that all of the elements of a voidable preference existed and awarded judgment for plaintiff.

The questions on appeal presented by defendant are summarized in the following specifications of error.

**D. Specifications of Error.**

1. The evidence does not support the following material findings of fact and conclusions of law:

(a) That on or about December 1, 1961, when the payment of the sums of $10,176.66 and $5,492.02 were made to defendant Archie Snider, and at all times thereafter, the bankrupt was insolvent within the meaning of § 1(19) of the Bankruptcy Act, as amended (T.R. 49).

(b) That on or about December 1, 1961, when the payment of the sums of $10,176.66 and $5,492.02 were made to defendant Archie Snider, and at all times thereafter, defendant Archie Snider had reasonable cause to believe that the bankrupt was insolvent (T.R. 49).

(c) That the payment to defendant Archie Snider of the sums of $10,176.66 and $5,492.02, as set forth in findings of fact nos. 6 and 7, constituted a voidable preference under § 60(a) and (b) of the Bankruptcy Act, as amended, and that plaintiff is entitled to judgment against Archie Snider, individually and doing business as Snider Construction Company, in the sum of $15,668.68, plus interest at the legal rate from March 20, 1962, and for plaintiff's costs of suit (T.R. 50).

2. The trial court committed reversible error in refusing admission of testimony and exhibits by the following witnesses of defendant:

(a) James H. Holderby:

Mr. Holderby, an assistant manager of the Mills Branch of the Bank of California in Burlingame, was testifying as to three credit inquiries to the bank relating to the bankrupt and the bank's replies to those inquiries. The three inquiries and three replies were offered into evidence as a group exhibit and were rejected upon plaintiff's objection "as incompetent, irrelevant, and immaterial, and they are hearsay and full of opinions and conclusion, and no indication of any tie in with the bankrupt corporation of plaintiff." (R.T. 103:14-18; this testimony and argument commences at R.T. 100:23 and concludes at R.T. 105:22.)

(b) Ernest Vedovie:

It was stipulated that Mr. Vedovie would testify as follows:

"He represented as broker the purchaser of the real property occupied by Mahl Associates. The purchase being consummated about December 1, 1961, and what he would testify, that the purchase price was based upon the $800 per month rent that Mahl was paying, and that he made an inquiry through his bank as to Mahl Associates. He got a Dun and Bradstreet report that indicated that Mahl Associates was a reasonably sound tenant based upon that report. That is all." (R.T. 121:14-22.)

The Court sustained the objection to that testimony "as not being impeachment. It is hearsay, and incompetent, irrelevant, and immaterial." (R.T. 121:23-24; this testimony and argument commences at R.T. 121:12 and concludes at R.T. 122:23.)

## II.

## STATEMENT OF FACTS

Mahl Associates, Inc., the bankrupt, was a California corporation. Its principal business was the purchase and installation of laundry and dry-cleaning equipment at commercial locations for the use of the general public (R.T. 6). Defendant, Archie Snider, was a small contractor who did business as Snider Construction Co. (R.T. 106, 107).

In April of 1961 Mr. Snider leased certain premises he owned to Mahl Associates (R.T. 7, 108). Shortly after taking possession, Kenneth Mahl, president of Mahl Associates, requested Mr. Snider to make additional enlargements and improvements so as to accommodate Mahl's expanding business (R.T. 7, 108). This work was done and Mr. Snider billed Mahl Associates a total amount of $5,492.02 in July and September of 1961 (R.T. 7, 109).

In August of 1961, Mahl went to Mr. Snider and said that the Corporation was temporarily short of working

capital and needed a loan to meet the current payroll; that it had requested loans from various banks; and, that such loans would soon be forthcoming (R.T. 9, 31, 110). He also said that work in progress and potential accounts receivable were substantial and would be collectible in the not too distant future (R.T. 111-112, 113).

As a result of these representations Mr. Snider advanced $10,000 to the corporation on August 15, 1961, and took a note for that sum payable on September 15, one month later (R.T. 9-10, 111). The note was not paid on the due date (R.T. 10-11, 111). After the note matured, Mr. Snider inquired of Mahl as to his intentions and was informed that the requests for loans had been turned down and that the corporation could not at that time retire the note or pay the bills for the construction work, but that there was substantial work in progress which would pay off in a short time and that the debts could then be paid (R.T. 11, 111, 113).

As landlord Mr. Snider, from the outset of Mahl's tenancy, customarily received the rent payments late, although rent was paid through October of 1961 (R.T. 112-113).

During September, October, and November of 1961 discussions concerning the debt owed Mr. Snider took place (R.T. 11-14, 33, 113) as a result of which the corporation, on or about December 1, 1961, sold certain real property it owned which was not being used in the conduct of its business and from the net proceeds of that sale satisfied all of its obligations to Mr. Snider (R.T. 13-14, 116-117).

On January 30, 1962, Mahl Associates, Inc. filed its voluntary petition in bankruptcy (R.T. 15).

This suit, judgment for plaintiff, and appeal by defendant, followed.

## III.

## ARGUMENT

### A. Introduction.

At the outset it must be emphasized that this is not the typical preference case where the trustee is seeking to recoup moneys for the benefit of the bankrupt's general creditors. Any recovery here will apply to the bankrupt's taxes which are the personal obligation of plaintiff's chief witness, Kenneth Mahl (R.T. 37-38, 99-100). This action was in effect prosecuted for Mahl's personal benefit.

Another important preliminary point should be made. There is no doubt that defendant's principal problem in this Court lies in the adverse findings of the trial court which defendant must establish were clearly erroneous. (Rule 52, Federal Rules of Civil Procedure.) But again, this is not the typical case. There is a presumption that payments made by a bankrupt to its creditors are valid and that the creditor who received the payment was acting in good faith. (3 Collier, *Bankruptcy,* §§ 60.54, 60.62, pp. 1074, 1127.) In deciding that this presumption was overcome by plaintiff, the Court in its memorandum opinion did not rely upon the testimony of plaintiff's witnesses as to the financial condition of the bankrupt at the time of the transfer. Instead, ultimate reliance was placed upon the obvious insolvency as of the date of the petition in bankruptcy, from which the Court inferred by use of the doctrine of "retrojection" that insolvency in the bankruptcy sense existed two months prior to the petition when the transfer to defendant was consummated (T.R. 45). On the question of defendant's knowledge of insolvency, the Court also refrained from relying upon the testimony of plaintiff's witnesses that this knowledge was actually imparted to defendant. Rather, the Court inferred that, under the circumstances, the de-

fendant had reasonable cause to believe that the corporation was insolvent (T.R. 47).

Due to the fact that these key findings are based upon inferences drawn from basically undisputed facts, this Court is free to independently evaluate the alternative inferences to which these facts give rise and to determine the validity of the inferences relied upon by the trial court. In *Mayo v. Pioneer Bank & Trust Company* (5th Cir. 1961) 297 Fed.2d 392, 395, it was held,

> "Under Rule 52(a) of the Federal Rules of Civil Procedure 28 USCA the trial judge's findings of fact are conclusive unless clearly erroneous, but when the factual determination is primarily a matter of drawing inferences from undisputed facts or determining their legal implications, appellate review is far broader than where disputed evidence and questions of credibility are involved. (Citations omitted.) Our scope of review in this case is broad since the decision turns not on what the (defendant) in fact believed, but on what (he) had reasonable cause to believe; and most of the basic facts are undisputed."

In *Moran Brothers, Inc. v. Yinger* (10th Cir. 1963) 323 Fed.2d 699, 702, Rule 52(a) was interpreted as follows:

> "'* * * A finding is "clearly erroneous" when although there is evidence to support it the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed.'" (Citation omitted.)

### B. Plaintiff Failed to Prove That the Bankrupt Was Insolvent at the Date of Transfer.

To show insolvency on the date of transfer, plaintiff was bound to prove that the bankrupt's liabilities exceeded its assets. This is a strict balance sheet test, and the mere show-

ing of a working capital deficiency is immaterial. (1 Collier, *Bankruptcy,* § 1.19[1], p. 90.)

In finding that the corporation was insolvent in the bankruptcy sense on the date the debt was repaid to Mr. Snider, the trial court ignored the testimony of Mahl and other witnesses for plaintiff as to the financial condition of the business and instead found insolvency on the crucial date by use of the doctrine of "retrojection" (T.R. 45).

Two elements are essential to the application of that doctrine: (1) At the time of filing the petition in bankruptcy the liabilities must greatly exceed the assets and (2) there must be good reason to assume that there had been no substantial change in the status of the business with respect to assets and liabilities between the date of the transfer and the date of filing the petition. (1 Collier, *Bankruptcy,* § 1.19[3]-[5], p. 125.)

The primary reasons why the lower court found it necessary to apply this doctrine apparently lies in the fact that the testimony of plaintiff's witnesses as to the financial condition of the business at the time of the transfer was confused and self-contradictory, and that prior to trial Mahl destroyed the corporate books and records, according, he claims, to the instructions of the trustee in bankruptcy! (R.T. 18)

In reaching the conclusion that the bankrupt was insolvent on the date of transfer, the trial court relied on testimony by Mahl that there had been no substantial change in the assets and liabilities of the business between the transfer on December 1st and the filing of the petition on January 30th (R.T. 76). The Court very significantly rejected Mahl's testimony that as early as July and August of 1961 his corporation was insolvent (R.T. 20-21). Mahl later admitted having submitted a financial statement to the Cali-

fornia Commissioner of Corporations showing a net worth of $139,000 as of June 30, 1961 (R.T. 21-22). Despite this "insolvency" Mahl failed to disclose it to prospective lenders from whom he was seeking money "right up until he filed bankruptcy." (R.T. 25-26, 46-47, 61)

The conclusion is inescapable that Mahl either made false representations to the prospective lenders, including the Small Business Administration, the Commissioner of Corporations, and defendant Snider, or he was not truthful to the lower court.

Additionally, Mahl later said that he did not know the true condition of the company until the schedule of assets and liabilties appended to the bankruptcy petition was prepared in January of 1962 (R.T. 78), that he did not know the state of the books in September and October of 1961 (R.T. 85), that he did not know whether the company had a positive net worth in October and November of 1961 (R.T. 81), and, in response to a question from the Court, that he did not believe the company was insolvent in September and October of 1961 (R.T. 85).

Mr. Liu, a business associate of Mahl (R.T. 121), shared office space with Mahl through November and December of 1961 (R.T. 32, 119). Mr. Liu testified that Mahl never told him that the company was insolvent or on the brink of bankruptcy in the later months of 1961, that he first learned that the business was going into bankruptcy around the beginning of 1962 (R.T. 120-121), and that this came as a surprise to him (R.T. 121).

It seems obvious that until the bankruptcy petition was actually filed there were substantial potential assets that could be realized upon by the corporation as a going business. The financial statements submitted to the California Commissioner of Corporations as of June 30, 1961, demon-

strate this (Deft's Exh. A). Not until the petition in bankruptcy was filed were assets such as advances to salesmen, equity in inventory, coin-operated laundries for resale (work in process), advances against salesmen's commissions, and reserves on sales contracts discounted with finance companies irretrievably lost. (See R.T. 23-25) In addition, upon the filing of the bankruptcy petition, accounts and notes receivable always drastically deteriorate in value.

This record does not support the district court's finding that it is "an inescapable conclusion that the bankrupt was insolvent at the time of the transfer." (T.R. 45, 49) The Court erred in applying the theory of retrojection since there was no good reason to assume that the status of the business had not changed from the date of the transfer to the date of filing the petition. And without the benefit of the theory of retrojection the trial court would not have found insolvency on the crucial date.

### C. Defendant Did Not Have Reasonable Cause to Believe That the Bankrupt Was Insolvent at the Time of Transfer.

#### 1. THE CASES.

In its memorandum opinion the trial court expressly declined to find that defendant Snider had actual knowledge of insolvency on December 1, 1961 when he received payment of the debt owing him (T.R. 46). The court found in favor of plaintiff on this essential element of a preference by determining that Mr. Snider had reasonable cause to believe that Mahl Associates was then insolvent (T.R. 47).

With respect to Mahl's testimony, some of which is above summarized, the court said that as president of the corporation he thought that the principal problem was a lack of working capital, that he was an almost incurable optimist in his business dealings, and that the corporation was suffer-

ing from greater financial problems than he was willing to admit (T.R. 46). *In effect, the trial court said that although Mahl may not have known that his company was insolvent in the bankruptcy sense, Mr. Snider should have known this fact.*

The court does not point in its memorandum opinion to the evidence upon which it relied in reaching this conclusion. The trial court merely cited the customary test that when financial information is brought to a creditor's notice which would lead a prudent business person to the conclusion that the debtor is insolvent then that creditor has reasonable cause to believe the debtor is insolvent (T.R. 47).

The evidence, at best, establishes that Mr. Snider had reasonable cause to suspect or be apprenhensive about the possibility that the corporation was insolvent. But, "apprehension or suspicion on the part of the creditor is not sufficient to constitute the 'reasonable cause to believe' which is required by section 60 of the Act." (3 Collier, *Bankruptcy*, § 60(2), p. 1066; see 8A Corpus Juris Secundum, *Bankruptcy*, § 215(3)(b), p. 23.)

This test was discussed in *Cate v. Certainteed Products Corporation* (1943) 23 Cal. 2d 444, 449, 144 P.2d 335, as follows:

> "A man may have many grounds of suspicion that his debtor is in failing circumstances, and yet have no cause for a well-grounded belief of fact. He may be unwilling to trust him further; he may feel anxious about his claim, and have a strong desire to secure it and yet still belief as the Act requires may be wanting. Obtaining payment of a debt under such circumstances is not prohibited by the law. * * * Hundreds of men constantly continue to make payments up to the very eve of their failure, which it would be very unjust and disastrous to set aside. * * * The debtor is often buoyed

> up by the hope of being able to get through with his difficulties long after his case is in fact hopeless and his creditors, if they know anything of his embarassments, either participate in the same feeling, or at least are willing to think that there is a possibility of his succeeding. To overhaul and set aside all his transactions with his creditors, made under such circumstances because there may exist some grounds of suspicion of his inability to carry himself through, would make the Bankruptcy Act an engine of oppression and injustice."

Moreover, even if the evidence, hereafter discussed, could be said to give rise to the inference that Mr. Snider had reasonable cause to believe that insolvency existed, it also gives rise with at least equal persuasion to an inference that Mr. Snider had reasonable cause to believe that Mahl Associates was not insolvent but that the corporation was merely short of working capital. In *Engelkes v. Farmers Co-Operative Company* (D.C. N.D. Iowa 1961) 194 F. Supp. 319, 329 the rule was stated as follows:

> "Where inferences from proved facts are to be drawn, the rule obtains that if two inferences of substantially equal weight may reasonably be drawn from the proved facts, then that inference shall prevail which sustains the transfer."

(See also 3 Collier, *Bankruptcy,* § 60.62, p. 1127 and cases there cited.)

In the preference cases which have found knowledge of insolvency or reasonable cause to believe that insolvency existed the defendant had knowledge of facts which are not present in this case:

> "Undercapitalization of the debtor, sales below cost, checks drawn on a bank account and payment refused by reason of insufficient funds, a consistent pattern of

overdrafts, operating losses, irregular, unusual or criminal conduct, secretiveness, slow payment, collection measures taken by other creditors, rescue of the debtor from embarrassment by friends or relatives, and reliance on financial statments or reports." (*Dean v. Planters National Bank of Hughes* (D.C.E.D. Ark. 1959) 176 F. Supp. 909, 914.)

It is, of course, well settled that the existence of an overdue indebtedness or knowledge that the debtor is experiencing financial difficulty in meeting current obligations is not sufficient to charge the creditor with having reasonable cause to believe that insolvency exists. (3 Collier, *Bankruptcy,* § 60.54, p. 1076.) Nor does the transfer of a debtor's assets to satisfy an obligation require a finding that the transferee has reason to be aware of insolvency. (*Employers' Mutual Casualty Company v. Hinshaw* (8th Cir. 1962) 309 Fed. 2d 806; Cowan, *Bankruptcy and Practice,* § 752, p. 402.)

In each of the following preferences cases, on evidence considerably more favorable to the plaintiff than the evidence in the instant case, the courts refused to find reasonable cause to believe that insolvency existed:

*Moran Brothers, Inc. v. Yinger* (10th Cir. 1963) 323 Fed. 2d 699: The court of appeals *reversed* the district court's finding of reasonable cause to believe where the evidence established that:

(1) The debtor failed to meet the obligation of making an escrow deposit;

(2) The debtor advised the defendant that funds were not available to be deposited to meet such obligation;

(3) The debtor gave postdated checks in payment of the obligation;

(4) The defendant expressed concern that the debtor would be unable to complete payment and said that he wanted funds at that time; and

(5) Payment on the postdated check was refused for insufficient funds when presented for payment.

*Lang v. First National Bank of Houston* (5th Cir. 1954) 215 Fed. 2d 118: No reasonable cause to believe insolvency existed even though:

(1) The defendant knew of the debtor's inability to meet current obligations;

(2) The debtor was in need of working capital and obtained loans from the defendant;

(3) The debtor had in the past generally repaid loans to the defendant when due, but had occasionally been somewhat late;

(4) The debtor was more than two weeks overdue on a current note to the defendant at the time the alleged voidable preference was made; and

(5) The defendant knew that the debtor-contractor had several lucrative jobs of substantial value in progress!

The court placed great emphasis on this latter factor:

> "To be sure, the appellee (creditor) knew that the bankrupt was having difficulty meeting current obligations which, after all, was the reason working capital was needed. But it also knew that the bankrupt had several lucrative jobs in progress and that some were near completion. . . . The bankrupt showed the appellee's officer that there were more than a half million dollars in retainages on one job alone, explaining that receipt of this amount would remedy the situation considerably." (P. 120.)

The existence of jobs in progress is a "crucial" factor (see *Mayo v. Pioneer Bank & Trust Company* (5th Cir. 1961) 297 Fed. 2d 392, 397); that factor is also present in our case (R.T. 111-112, 113).

*Sumner v. Parr* (D.C.S.D. N.Y. 1919) 270 Fed. 675: Findings were made in favor of the preferred defendant even though:

(1) He had not attempted to ascertain the value of the bankrupt's business and real estate holdings;

(2) He knew the bankrupt was slow in payments and had been for some time;

(3) He had been obliged to take notes from the bankrupt when the bankrupt could not make prompt payment; and

(4) He had become suspicious of and unsatisfied with the bankrupt's delays and had demanded and obtained security for the debt.

The court noted, "[T]here were no immediate suspicious circumstances. Nothing had just happened which should have caused (defendant) to suppose that the bankrupt was any nearer insolvency than she had been for some time." (P. 676.)

*Engelkes v. Farmers Co-Operative Company* (D.C.N.D. Iowa, 1961) 194 F. Supp. 319: No reasonable cause to believe insolvency existed where:

(1) The defendant was informed by the bank that the bankrupt was a "thin operator";

(2) The check given by the bankrupt to the defendant in payment of its obligation was twice refused payment for insufficient funds;

(3) Defendant was informed that other checks issued by the bankrupt were being refused payment on the grounds of insufficient funds;

(4) Defendant pressed the bankrupt hard for payment and gave the bankrupt an ultimatum and threatened that the account would be turned over to an attorney for action: and

(5) Defendant knew that the bankrupt had given him erroneous information regarding accounts receivable.

These facts were found to support inferences both of insolvency as well as mere financial difficulty:

> "'As one views any business failure in the retrospect, many incidents and circumstances bearing upon a bankrupt's financial condition loom much larger and more formidable than they did before the crash occurred. All well considered cases have enunciated the doctrine that mere apprehension on the part of the creditor is not equivalent to good cause to believe that insolvency exists * * *'" (Citations omitted; p. 329.)

*Salter v. Guaranty Trust Company of Waltham* [D.C. Mass. 1956] 140 F.Supp. 111: The court found no reasonable cause to believe notwithstanding the following facts:

(1) The bankrupt failed to repay a loan to defendant bank when due and then obtained a renewal of that loan;

(2) The bankrupt's account balance at defendant bank continually declined and eventually became overdrawn;

(3) There was a great deal of work in progress which the bankrupt said would result in funds to pay off the obligation;

(4) The renewal loans were paid off before maturity;

(5) A writ against the bankrupt was served on the defendant bank; and

(6) The defendant bank knew throughout that the bankrupt lacked ready cash to pay its bills when due.

*Cate v. Certainteed Products Corporation* (1943) 23 Cal. 2d 444, 144 P.2d 335: Determination of no reasonable cause to believe was based upon the following evidence:

(1) The obligation owed to defendant was four months overdue;

(2) Credit reports showed the bankrupt as customarily slow in paying his obligations;

(3) A credit agency advised defendant that the bankrupt's account should be watched closely;

(4) Defendant was advised of the bankrupt's intention to have a bulk sale of its stock in trade;

(5) Defendant discovered that the bankrupt's place of business was under attachment;

(6) The bankrupt had a large amount of accounts receivable but was slow in making collections;

(7) A compromise and settlement of the account was reached as a result of which the bankrupt gave defendant a postdated check which was subsequently twice refused for insufficient funds and was, upon defendant's demand, replaced by a certified check at a time when the debtor stated he was solvent and that he intended to stay in business by changing the character of his operations.

**2. THE EVIDENCE.**

In this case the evidence before the trial court showed that at the time of the December 1, 1961 transfer the bankrupt had owed Mr. Snider some $1,200 since July of 1961 (R.T. 8, 109) and some $4,200 since mid-September of 1961 (R.T. 8, 109); that the bills represented costs of alterations and construction of additional office space for the corporation's expanded operations (R.T. 8, 109); and that Mr. Snider had been owed $10,000 for a loan of working capital since mid-September (R.T. 10, 111). The evidence also was that although the corporation had been customarily late in paying the rent it had paid through the month of October (R.T. 112-113); that the entire obligation to Mr. Snider was being satisfied by real property owned by the corporation but undeveloped and not used in its business (R.T. 10, 13, 116-117); that the corporation had substantial assets which were dependent upon its continuing in business (R.T. 23,

111); that Mr. Liu, a business associate of Mahl, who shared office space with the corporation, had no suspicions at that time of bankruptcy (R.T. 121); and that Mahl himself did not really believe that the corporation was insolvent (R.T. 85-86).

Much was said at the trial concerning a purported conversation between Mahl and Mr. Snider in October of 1961 (R.T. 11-12, 34-37, 113, 117-118). At one point in the record Mahl stated that he told Mr. Snider, "that I was insolvent and it had been suggested by my accountant and attorney to file a petition in bankruptcy." (R.T. 13) The trial court in its memorandum opinion gave little, if any, credence to this testimony. Mr. Snider denied any such statement was made (R.T. 113); he said that Mahl did tell him that he was unable to pay the debts because he was "temporarily short of cash." (R.T. 114) Significantly, Mahl was soliciting funds from Mr. Snider during this period (R.T. 47), and Mahl stated flatly that he would not have asked Mr. Snider for additional funds if he had told him of any impending bankruptcy (R.T. 47). French, a business associate of Mahl at the time of trial (R.T. 62), as well as a vice president of the bankrupt corporation (R.T. 50), also testified that Mahl tried to induce Mr. Snider to invest in the business in October (R.T. 65). Obviously Mahl was not seeking more money from Mr. Snider at the same time he was forecasting financial ruin to this prospective lender.

In his deposition prior to trial Mahl said that he "did not recall" any conversation with Mr. Snider after September 15, when the note became due (R.T. 35-36), and that he did not tell Mr. Snider that the business was broke (R.T. 36-37).

During this time Mahl was soliciting loans from other sources as well yet said he did not tell these other sources of imminent financial disaster (R.T. 46-47; 61).

The complete explanation for this conversation (between Mahl and Mr. Snider), if it occurred at all, was provided by French, plaintiff's witness. According to French Mr. Snider was told that *unless* financing were obtained Mahl had been advised to institute bankruptcy proceedings (R.T. 51). Also according to French, Mr. Snider was merely informed "that we needed working capital." (R.T. 65) Such statements are entirely consistent with the present existence of a positive net worth of a going business, based on receivables, work in progress, and similar assets, which Mr. French said did in fact exist in October and November (R.T. 58). French at that time believed that the corporation was solvent (R.T. 53-54; 58). Solvency in the bankruptcy sense may exist even though working capital might not exist. (1 Collier, *Bankruptcy,* § 1.19[1], p. 90.)

**D. The Court Erred in Excluding the Evidence Offered by Defendant Through Messrs. Holderby and Vedovie.**

In its memorandum opinion the district could quoted from the recent decision of this Court in *I-T-E Circuit Breaker Company v. Holzman* (9th Cir. 1965) 354 Fed. 2d 102, 105: "A creditor may not close his eyes in order to remain ignorant of the debtor's true condition; and the creditor is chargeable with notice of all facts which a reasonably diligent inquiry would have disclosed." (T.R. 47)

What would a reasonably diligent inquiry have revealed to Mr. Snider? The testimony and exhibits which the prospective witnesses Holderby and Vedovie would have provided, had the court permitted the introduction of this evidence, could have answered this question. It was reversible error, for that reason, to exclude the evidence.

Mahl Associates, the debtor corporation, did business with the Mills (Burlingame) office of the Bank of Califor-

nia. Mr. Holderby, the assistant manager of that branch, testified that the bank's credit file on Mahl Associates contained responses by the bank on November 15, 1961, and October 27, 1961, to credit inquiries addressed to the bank by other prospective lenders to the corporation (R.T. 102; Deft's Exh. C for identification).

Had he been permitted to testify, Mr. Vedovic, a real estate broker who represented the purchaser of the real property occupied by Mahl Associates, would have testified that his principal's purchase price was based upon the $800.00 rent Mahl Associates had been paying and that as of the date of the alleged preferential transfer (December 1, 1961) he had concluded from credit inquiries through his bank and through Dun & Bradstreet that Mahl Associates was then a reasonably sound tenant (R.T. 121).

This evidence, if received, would have established beyond doubt that a reasonably diligent inquiry by Mr. Snider would not have revealed insolvency of the corporation; on the contrary, it would have indicated just the opposite.

If Mr. Snider would have been even more curious, what would Mahl and his associates have revealed? Mahl himself did not believe he was insolvent (R.T. 85), nor did French, his principal financial adviser (R.T. 53-54, 58). If Mr. Snider had asked to see the books of the corporation they would have revealed little, if anything, since they were not in shape and financial statements had not been prepared since the preceding June 30 (R.T. 24, 52, 85). Mahl testified that until the schedules were prepared for the petition in bankruptcy he had no accurate idea of what financial condition the business was in (R.T. 78, 85).

## IV.

## CONCLUSION

To establish a voidable preference under § 60 of the Bankruptcy Act it was incumbent upon plaintiff to prove by a fair preponderance of the evidence two vital elements, the existence of which are disputed, namely, (1) that Mahl Associates was insolvent on December 1, 1961, and (2) that Archie Snider had reasonable cause to believe that Mahl Associates was then insolvent.

Plaintiff's evidence of these elements must be so strong as to overcome the presumptions that the transfer was valid and was received by Mr. Snider in good faith. (3 Collier, *Bankruptcy,* §§ 60.54, 60.62, pp. 1074, 1127.) Moreover, the scope of review in this case is particularly broad since the decision below turned not on what Mr. Snider actually believed but on what he had "reasonable cause" to believe, and most of the facts are undisputed. *Mayo v. Pioneer Bank & Trust Co., supra,* 297 Fed. 2d 392, 395.

Plaintiff failed to meet these tests. He failed to prove that the business had not substantially changed from the date of the transfer to the date of the filing of the bankruptcy petition. This being the case, the trial court erred in applying the doctrine of retrojection and in finding that the bankrupt was insolvent on the date in question.

Plaintiff failed to prove that Mr. Snider had reasonable cause to believe that the bankrupt was insolvent on the crucial date. The evidence establishes at best only that he had reasonable cause to suspect or be apprehensive of insolvency. The trial court's finding that the defendant had reasonable cause to believe that the bankrupt was insolvent on the date in question is therefore unsupported by the evidence. The trial court inferred from the facts that defendant had reasonable cause to believe the corporation was insolvent. The evidence sustains with at least equal weight the inference that Mr. Snider had reasonable cause to be-

lieve, and did believe, that the bankrupt was merely temporarily short of working capital and not insolvent. Thus, the court erred in failing to apply the rule that if two inferences of substantially equal weight may reasonably be drawn from the proven facts, then that inference shall prevail which *sustains* the transfer. (*Mayo v. Pioneer Bank & Trust Company, supra,* 297 Fed. 2d 392, 395.)

Finally, the court erred in excluding evidence presented on behalf of Mr. Snider which would have shown that any inquiry by him into the financial condition of the bankrupt not only would have given no knowledge or reasonable cause to believe insolvency existed but would have affirmatively reinforced his belief that the bankrupt was merely temporarily short of working capital.

For each and all of these reasons the judgment must be reversed.

Dated: August 19, 1966.

Respectfully submitted,

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## CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

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